

HONORABLE JOHN C. COUGHENOUR

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

UNITED STATES OF AMERICA,)	
)	NO. CR04-0173C
Plaintiff,)	
v.)	DEFENDANT'S SENTENCING
)	MEMORANDUM
ALPHA TECHNOLOGIES, INC.,)	
)	Sentencing Hearing:
Defendant.)	June 25, 2004

I. INTRODUCTION

Alpha Technologies, Inc. ("ATI"), by and through its attorneys, Robert M. McCallum and Bradley A. Smith, submits this memorandum in connection with the sentencing hearing scheduled for June 25, 2004. The sentencing is scheduled jointly with the sentencing in United States v. G. B. Enterprises, Inc., No. CR04-0172C. Due to the factual relationship between these two cases, this memorandum discusses both cases. For the reasons stated below, ATI respectfully requests that the Court impose the sentences provided for in the two plea agreements proposed by the United States Attorney, ATI and G. B. Enterprises, Inc. ("GBE"), both of which plea agreements are supported by the United States Probation Office.

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DEFENDANT ALPHA TECHNOLOGIES, INC.
SENTENCING MEMORANDUM – 1

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1 **II. SUMMARY OF SENTENCING RECOMMENDATION**

2 Pursuant to Federal Rule of Criminal Procedure 11(c)(1)(C), the United States, ATI
3 and GBE request that the Court impose the sentences provided for in the plea agreements.

4 The primary elements of the sentences are summarized below.

- 5 • ATI agrees to pay the maximum statutory fine of \$500,000
6 • ATI agrees to be sentenced to probation for a period of one year
7 • GBE agrees to pay the maximum statutory fine of \$500,000
8 • GBE agrees to be sentenced to probation for a period of three years
9 • GBE agrees to make full restitution of more than \$35,000,000

10 In addition, both ATI and GBE have paid \$400 special assessments to the Clerk of the Court.

11 In light of the fine and restitution to be paid by GBE, the total financial cost imposed on the
12 two companies in connection with the settlements exceeds \$36 million.

13 **III. PROBATION OFFICE RECOMMENDATION**

14 The U.S. Probation Office fully supports the settlements proposed by the U.S.
15 Attorney, ATI and GBE. There are no formal objections, under Federal Rule of Criminal
16 Procedure 32, to be resolved prior to sentencing.

17 **IV. ALL FINES & RESTITUTION WILL BE PAID IN FULL**

18 ATI and GBE have each agreed to pay the maximum statutory fine, in the amount of
19 \$500,000, immediately after the Court's imposition of the sentences provided for in the plea
20 agreements. Further, GBE has agreed to make full restitution to the Internal Revenue Service
21 ("IRS"). The restitution is comprised of income tax, civil tax penalties, and accrued interest
22 on the income tax and civil penalties. Part of the restitution has already been paid in the form
23 of estimated income tax payments. GBE has agreed to pay the balance of the restitution, in
24 the amount of \$32,911,999, immediately upon imposition of the sentences provided for in the
25 plea agreements.

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V. TERMS OF PROBATION

ATI and GBE have both agreed to be sentenced to organizational probation. The conditions of probation for each company are substantially the same. For instance, in addition to the Court's standard conditions of probation, both of the companies have agreed to three additional specific conditions. First, each company will account for all foreign transfers of funds on an annual basis. Second, ATI and GBE will each employ a tax and accounting staff separate and apart from the other. Third, ATI and GBE will each engage an independent CPA firm not previously associated with the preparation of its income tax returns to prepare its tax returns in the future.

VI. PLEAS REPRESENT NEGOTIATED COMPROMISE

The Government's sentencing memorandum alludes to a number of issues about which the Government and ATI disagree, but which form the basis for a compromise. The following comments describe some of those issues.

A. Alleged single-minded obsession with tax avoidance

ATI and GBE paid over \$14,000,000 in Federal income tax during the years at issue in the criminal investigation. ATI and GBE paid the taxes on net income attributable to the management, engineering and sales support services provided by ATI and its subsidiary, Comm/Net, Inc., and the manufacturing and distribution functions performed by GBE.

Moreover, as Judge Learned Hand wrote seventy years ago, "[a]nyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935).

Furthermore, three jurisdictions now assert the right to tax the same income at issue in these cases. First, Alphatec reported the "residual commissions" at issue in Cyprus. As a result, those amounts have been taxed in Cyprus. Second, the Canadian tax authority asserts the right to tax the "residual commissions" paid through April of 1997. The total

1 amount sought in the Canadian civil tax controversy is now approximately CA\$30,000,000.
2 Third, as an integral part of the settlement of the criminal prosecutions, the IRS proposes to
3 increase the gross income shown on GBE Forms 1120 U.S. Corporation Income Tax Return,
4 for the years 1994 through 2001, by \$56,879,852, as an approximation of deductions claimed
5 by GBE for business expenses payable to Alphatec. To settle the civil tax consequences of this
6 case with the IRS and the criminal prosecution with the U.S. Attorney and the U.S.
7 Department of Justice, GBE has agreed to the proposed adjustments.

8 B. Appropriateness of payments

9 The Government correctly states that ATI would claim at trial that the “residual
10 commissions” payments at issue represented appropriate compensation. For many years, Mr.
11 Kaiser received nominal compensation from ATI and he considered the amounts at issue to be
12 fair and equitable compensation for many years of very hard work.

13 C. Alleged failure to acknowledge the payments to Cyprus

14 Mr. Kaiser had almost no direct involvement in the IRS audit that led to the
15 criminal prosecutions. He was constantly on the move focusing on his customers. However,
16 in the one and only meeting between Mr. Kaiser and the IRS, Mr. Kaiser voluntarily appeared
17 and did, in fact, indicate that “residual commissions” were being paid to Alphatec in Cyprus,
18 as is shown by the IRS agents’ notes and schematic diagrams made during the meeting.

19 D. Alleged obstructionist behavior

20 The Government seems to equate resisting a grand jury subpoena with obstruction
21 of justice. ATI disagrees. After inquiry, ATI counsel have not been informed of any conduct
22 that constitutes obstruction of justice in these cases. Further, it is our understanding that the
23 witness referenced by the Government independently retained legal counsel and asserted
24 privilege with respect to certain documents requested in the subpoena.

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1 E. Government statements regarding extradition

2 Counsel for ATI cannot comment on “information provided to federal law
3 enforcement agents” regarding Mr. Kaiser’s whereabouts, as that information has not been
4 provided by the Government. However, while Mr. Kaiser has for the past 25 years regularly
5 attended industry trade shows in the United States as an important part of his customer-centric
6 business philosophy, he is typically present in the United States on less than 120 days per
7 year. Throughout this eight year investigation, Mr. Kaiser has traveled to and from the
8 United States on a regular basis.

9 F. Reliance on advice of counsel

10 The Government also correctly states that individuals at ATI and GBE relied on
11 the advice of legal and accounting professionals, and that the Government would encounter a
12 “stiff defense” at trial based on the deductibility of the “residual commissions” payments at
13 issue. In fact, during the criminal investigation, GBE’s prior counsel, who represented GBE
14 from 1998 through 2003, filed the GBE Forms 1120 U.S. Corporation Income Tax Return, for
15 the years 1997 through 2001, showing the deductions at issue. GBE’s counsel was aware of
16 the facts regarding those deductions and disclosed the fact that the deductions were being
17 claimed on the returns.

18 **VII. CONCLUSION**

19 The civil and criminal investigation in this matter has gone on for over eight years, in
20 large part because of the perception on the part of the IRS that it was misled by a former Chief
21 Financial Officer in the course of an IRS audit. In fact, the prosecutions are as much about
22 the circumstances that created that perception as they are about the deductibility of the
23 “residual commissions” payments to Alphatec.

24 As the government has indicated in its sentencing memorandum, the plea agreements
25 under Rule 11(c)(1)(C) represent a negotiated compromise. To settle the criminal prosecutions
26 with the U.S. Attorney and the U.S. Department of Justice, GBE and ATI have agreed that

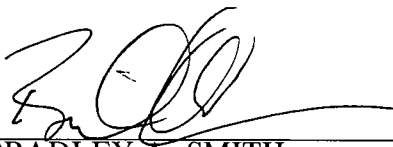
1 GBE's Form 1120 U.S. Corporation Income Tax Return, for the calendar year 1996, was false
2 as to a material matter. Further, ATI has agreed that it assisted in the preparation of the GBE
3 Form 1120, for the 1996 tax year, as part of the tax and accounting services provided to GBE.

4 In conclusion, we urge the Court to impose the agreed upon sentences, which are
5 recommended by all of the parties in this matter, as well as the United States Probation Office.
6 The time has come for all parties to put this matter behind them and, most importantly, for the
7 companies and their employees to move forward.

8 RESPECTFULLY SUBMITTED this 20th day of June, 2004.

9 LeSOURD & PATTEN, P.S.

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1 **CERTIFICATE OF SERVICE**

2 I hereby certify that on June 21, 2004, I electronically filed the foregoing with the
3 Clerk of Court using the CM/ECF system, which will send notification of such filing to the
4 other attorneys of record. I hereby certify that I have served the attorneys of record that are
5 not CM/ECF participants via telefax.

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